Comments on paper by Kozicki and Tinsley

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What I like most about this paper:

It makes sense!

A recent episode

- In Greenspan's "H-H" testimony last month, he said $\pi^* = \pi_t$ (under 1% for core PCE).
- This surprised several (many? but not all) FOMC members (quotes on p. 19).
- Bond yields adjusted *down* => market's perception of Fed's inflation target *fell*?
- According to Fig. 9, long rates should rise and output should *fall*.

✓ Why? Lower π^* => policy should *tighten*

✓ Maybe this "news" was more about *perceived* π^* than *actual* π^*.

It makes sense

- **"…the inflation goal is assumed only to be known by the monetary authority" (p. 4)**
- ✓ We *know* the Fed has not revealed p*; it's been a guessing game.
- ✓ Maybe the FOMC does not even know p*! (an interesting variant?)
- **The estimated target reflects changing aspirations (See Fig. 1)**
- ✓ rose in the inflationary 1970s (resignation)
- ✓ fell sharply in the Volcker disinflation (determination)
- ✓ settled in near 3-4% when p did (satisficing)
- ✓ drifted down as p did in 1990s (opportunism)
- **It's estimated, not calibrated**

The model of target inflation

- **“The [Fed’s] inflation target follows a martingale process…” (see eq. 2, p. 10)**

✓ I wonder about this. Aspirations idea suggests lagged/current p should affect p*.

✓ Volcker “dummy” is a sharp counterexample (or example): target falls for 13 consecutive quarters.

- **Public perceptions are adaptive (see eq. 5, p. 14), so they lag p* **

Other aspects of the model

- **Same *perceived* inflation target in the SR (funds rate) and LR (bond rate)**

✓ Odd when movements in p are predictable?

✓ Compare situation today

- **Constant real natural rate**

✓ 3% seems high for the funds rate

- **No structural breaks *other than in the inflation target***

The history told by Figure 1

- **p* moves a bit too rapidly? Smooth it?**

✓ 1969-1971: drops ~ 3 points

✓ 1979-1982: drops ~ 8.5 points (Text, p. 18, attributes 4.5 points to the “dummy”.)

✓ Dips below zero in 1982-83

✓ Falling in 1994-1996 period

- **Large discrepancies between *actual* p* (fast-moving) and *perceived* p* (slow moving)**

Major changes in impulse response patterns

- p reaction to an AD shock is drastically reduced (Fig. 5)
- All reactions to an AS shock change dramatically (Fig. 6)

✓ y response changes sign

- p and y responses to a transitory policy shock change dramatically (Fig. 8)

✓ p response changes sign => no price puzzle

Conclusions

- The new wrinkle matters.
- The new wrinkle makes sense.
- Smoother behavior of p^* might make even more sense.